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TIMBER MANAGEMENT

U.S. DEPARTMENT OF AGRICULTURE
Washington, D.C. 20250

FOREST SERVICE
Revised May, 1972
FS-341

FEDERAL INCOME TAX TIPS FOR THE TIMBER OWNER

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It is likely that many individual timber owners pay a larger Federal income tax on their woods operations than the law requires. This results in part from failure to deduct an allowance for depletion representing the owner's unrecovered investment in the timber harvested. Also, many owners do not realize that the cutting or sale of timber can frequently result in capital gain rather than ordinary income, and that this can substantially reduce their tax.

The following discussion and examples cover typical income tax situations of *individual* forestland owners. A clearer understanding of income tax procedures should benefit the taxpayer financially and should at the same time encourage better forest management. This material is current as of February 1972.

Consideration is given to treatment of the costs of forest ownership and operation, to receipts from sales of timber and other forest products, and more briefly to losses of timber from casualties, theft, and condemnation. No attempt is made to cover all aspects of the subject. This publication which has been revised by the Internal Revenue Service is intended merely as a guide, based on law and regulations in effect at the date of publication. Each taxpayer must consider all the facts and circumstances in applying the laws and regulations to his own situation. A more complete discussion will be found in Agriculture Handbook No. 274, "The Timber Owner and His Federal Income Tax," for sale by the Superintendent of Documents, Washington, D. C. 20402, price 50 cents.

Costs of Forest Ownership and Operation

For income tax purposes your expenditures as a forest owner may be classified as (a) additions to capital, such as the purchase of land or timber, (b) deductions from gross income, such as operating expenses, or (c) deductions from timber sale proceeds, such as expenses of sale. Certain expenditures which are ordinarily deductible, such as taxes, interest on indebtedness, and other carrying charges may, at the election of the taxpayer, be capitalized.

In addition to out-of-pocket expenditures, you will have costs of an accounting nature that represent, in a sense, the "recovery" of capital expenditures previously incurred. Such items are timber depletion allowances on the one hand and depreciation and amortization allowances on the other. Timber depletion is closely related to treatment of timber sale proceeds and is taken up in connection with that topic.

Capital Expenditures

You may incur capital expenditures either for the acquisition of property or property rights or for permanent improvements that increase the value of property you already own. Examples of the former are purchases of timber and of equipment having a useful life of more than 1 year, or acquisition of rights-of-way or other easements extending more than 1 year. Examples of the latter are expenditures for bridges, roads, and firebreaks; for tree planting and seeding; and for major repair of equipment that prolongs its useful life.

Capital expenditures may not be deducted from gross income on the tax return year by year as paid or incurred but must be "capitalized," that is to say, set up on the taxpayer's books through charges to one or more capital accounts. Whether for acquisition or improvement, capital expenditures are of three broad types: those relating to the land account, the timber account, and the equipment account.

When timberland is purchased, you should make an allocation of the total purchase price including costs of appraisal, land survey, title search and insurance, recording fees, and legal services. The total amount paid for the property should be allocated over the timber, land, and buildings in the proportion that the fair market value of each, as of the date of purchase, bears to the fair market value of the property as a whole, as of the date of purchase.

Amounts paid or incurred in connection with the planting of timber, including planting for Christmas trees, are charged to the plantation (also known as a deferred reforestation) subaccount. Such costs include expenditures for the preparation of the timber site for tree planting or seeding and for the

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cost of seedlings or tree seeds. The cost of hired labor employed in tree planting or seeding must also be capitalized. The term "hired labor" includes members of the taxpayer's family who are actually paid for their services; it does not include the taxpayer himself.

The young-growth and plantation subaccounts are credited as timber becomes merchantable. Such amounts are then charged to the merchantable timber account for recovery through the timber depletion allowance at such time as the timber is sold or harvested.

The costs of durable equipment such as a sawmill, trucks, tractors, or powersaws are set up in an equipment account and are recoverable through depreciation allowances.

Operating Expenses

You may deduct from gross income the ordinary and necessary expenses paid or incurred during the year in carrying on a trade or business. Also, an individual taxpayer, as contrasted with a corporate taxpayer, may deduct ordinary and necessary expenses for the management, conservation, or maintenance of property held for the production of income.

Operating expenses include expenditures for tools of short life (usually thought of as less than 1 year) or small cost such as axes, handsaws, sledges, wedges; also operation and maintenance including incidental repairs of trucks, tractors, and other mechanical equipment used in your forest operations. Deductible also are amounts paid for hired labor provided such amounts are not required to be capitalized. Rentals or other payments for land, equipment, or other business property in which the taxpayer has no equity may be deducted, provided such expenditures are not directly related to an activity such as timberland purchase, reforestation, or timber sale, in which case they are capital expenditures.

Carrying Charges

In the case of forest tracts producing current income, interest charges, taxes, and insurance premiums are normally deducted year by year as operating expenses. In the case of properties not producing current income, such items are regarded as carrying charges which may be capitalized at your election.

Taxes that come under the heading of carrying charges include annual property taxes and also acreage (bare land) taxes payable on forest tracts subject to yield tax provisions. Yield or severance taxes payable only at time of timber harvest, on the other hand, do not qualify for such treatment. Federal income taxes, estate, inheritance, and gift taxes, and special assessments for local benefits tending to increase the value of the property assessed may not be deducted. Interest charges may be deducted when they represent actual out-of-pocket expenditures.

Under ordinary circumstances, the individual timber owner not engaged in current timber operations would probably not take advantage of the election to capitalize carrying charges, but would deduct such items each year in computing his tax liability.

However, an individual who acquires a stand of growing timber with the thought of cutting it in some future year, and who uses the Standard Deduction or a Tax Table in computing his tax, instead of itemizing his deductions, would want to capitalize these expenses because they would otherwise be wasted.

Expenses of Sales

Advertising and costs such as timber cruising, marking, and scaling directly related to a specific sale of timber are treated as expenses of sale. Such items would also include fees of consulting foresters or other advisors for work directly related to a sale of timber. In a transaction reported as a sale or exchange of a capital asset, selling expenses are treated as an offset to the selling price and are deducted on Schedule D as explained under "Receipts from Sales of Timber and Other Forest Operations."

Depreciation

You are permitted a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in your trade or business or held for the production of income. This allowance takes the form of an annual depreciation deduction on the tax return. Moreover, up to 20 percent of the cost of certain property may be claimed as additional depreciation for the first tax year for which a depreciation deduction is allowable on the property; usually the year of purchase. A tax credit (investment credit) may also be allowed based on the investment in certain depreciable property. Detailed discussions of depreciation allowances and the investment credit are contained in IRS Publication 534, "Tax Information on Depreciation," and Publication 572, "Tax Information on Investment Credit," which may be obtained free from your Internal Revenue office.

Receipts from Sales of Timber and Other Forest Operations

The Amount of Gain or Loss

Gain or loss on the sale or other disposition of timber, as in the case of property in general, is the difference between the amount received and the

cost or other "basis" of the property. Many forest owners overlook the fact that they may have a basis that can be attributed to the timber sold.

The cost or other basis for gain or loss.—In the case of purchased timber your basis is ordinarily its cost. Special rules apply, however, if the timber was purchased prior to March 1, 1913, or if the property was acquired by gift, inheritance, or through exchange. If at the time you acquired timberland no separate timber valuation (exclusive of land and buildings) was established, you will need to know whether a part of the total acquisition value should have been allocated to merchantable timber or to young growth as explained under the heading "Capital Expenditures." If you acquired cutover land, or land with little or no merchantable timber on it when acquired, there would probably have been no original basis to be entered in your timber account. Where the timber value was a significant part of the total cost but its quantity and value at time of acquisition are unknown, you may need the assistance of a forester to determine this information.

The adjusted basis.—The original basis of your timber will need to be adjusted from time to time to keep current the dollar amount shown in the merchantable timber account. The basis will need to be increased by the value allocated to additional timber purchases and by the amount of carrying charges that may have been capitalized. Adjustments may also include decreases to the account to reflect timber sales or casualty losses during the preceding year. Adjustments to the basis for gain or loss are illustrated in the example that follows.

The quantity of merchantable timber.—When merchantable timber is first acquired, the quantity expressed in board feet, cords, or other unit should be estimated on the basis of the total volume that the tract would have produced on the date of acquisition if utilized in accordance with the standards prevailing in the region at that time. The quantity should be increased each time you acquire additional timber; likewise if you have cut or sold timber in prior years the account should have been decreased in such years by the number of units cut or sold. Periodic adjustments for growth should be made; however, the owner of a small timber holding who has infrequent transactions would generally make this determination only for a year in which he cuts, sells, or otherwise disposes of timber.

The depletion unit.—This is found by dividing your adjusted basis for depletion by the total quantity of timber. The unit is usually expressed in dollars per thousand board feet or per cord, but the individual tree may be the physical unit as in the case of Christmas tree plantations.

The gain or loss for tax purposes.—The depletion unit multiplied by the number of units disposed of is the basis for determining gain or loss on the transaction. This amount plus any expenses in connection with the timber disposal, such as timber surveys and advertising, is subtracted from the amount received, and the difference is the gain or loss to be reported on your return.

Example 1.—Mr. Brown bought a farm for $10,000 in 1940 and determined that $1,500 of the purchase price should be allocated to standing timber located on a part of the farm. In 1956 he bought a 100-acre timber tract adjoining his farm. He paid $2,500 for the second property, $60 for a timber cruise and boundary survey, and $40 for title search and recording the deed, bringing the total cost to $2,600. He allocated $600 ($6 per acre) to the land and $2,000 to the timber. At the time of purchase all of the timber on the two tracts was considered merchantable, and no part of the cost of timber was allocated to young growth. Mr. Brown did not make an election for any year to capitalize taxes or other carrying charges pertaining to the timber. The quantity of timber on the first tract at the time of purchase was 300,000 board feet, and that on the second tract at the time of purchase was 190,000 board feet.

In 1971 Brown decided to dispose of 60,000 board feet. He had not cut or sold or otherwise disposed of any of the timber in prior years. He determined that timber growth since he acquired the two tracts was 100,000 board feet. Brown's depletion unit for determining gain or loss on this disposition is $5.93 per M board feet, and the basis for gain or loss is $355.80 as shown below.

	Timber investment	*Timber quantity (M bd. ft.)*
First tract	$1,500	300
Second tract	2,000	190
Timber growth since purchase	.....	100
Adjusted basis for depletion	$3,500	...
Total timber available for cutting	.....	590
Depletion unit ($3,500 ÷ 590 M bd. ft.)		$ 5.93
Basis for gain or loss on 60 M bd. ft. of timber sold ($5.93 × 60 M bd. ft.)		355.80

Timber depletion occurs when you cut standing timber. Your depletion allowance is calculated in the same manner as when timber is sold. Income tax regulations require that you keep accurate and complete records in order that depletion allowances and other figures used in computing gain or loss on timber transactions may be supported.

The Type of Gain or Loss

The tax treatment of gain or loss from the sale or other disposition of timber and the manner of reporting it on your return, depend upon whether you have an "ordinary" gain or loss or "capital" gain or loss. Ordinary income is fully taxable and ordinary losses are, for the most part, fully deductible. Capital gains and losses on the other hand are subject to special rules which will generally result in tax benefits to you.

Whether your gains or losses from timber transactions are treated as ordinary or capital gains and

losses will depend upon such factors as the purpose for which the timber was held, the length of time you owned it before disposal, the form of disposal, and the nature of the product. Ask yourself which of the following situations applies to you:

Sale of standing timber for a lump sum;
Disposal of standing timber with an economic interest retained;
Cutting of timber with election to treat as a sale;
Sale of forest products other than standing timber.

Sale of standing timber for a lump sum.—A lump-sum sale is one in which you sell timber outright and are paid a fixed amount agreed upon in advance. The sale may cover all the timber standing on a given tract of land, or it may cover certain species, diameter classes, or marked timber only.

Whether a lump-sum sale will result in ordinary or capital gain or loss depends upon whether the timber is considered to have been a capital asset in your hands. In general, if you make only an occasional sale of timber unrelated to a trade or business in which you are engaged (not necessarily your principal occupation) the timber will qualify as a capital asset, and proceeds of sale will be entitled to capital gains treatment. If, however, you are a dealer in timber or timberland or make repeated sales of standing timber you may, upon audit of your return, have the tax status of your timber transaction questioned. Taxpayers making repeated sales of timber held for more than six months often dispose of it in such a manner as to retain an economic interest and so avoid this problem.

Sale or exchange of a capital asset held more than 6 months at the time of disposal leads to a long-term capital gain or loss, whereas sale or exchange of a capital asset held 6 months or less leads to a short-term capital gain or loss. Net long-term capital gains of individuals are reduced by 50 percent before inclusion in taxable income. However, the tax on net long-term capital gain cannot exceed 25 percent of the first $50,000 of such gain. Tax on the net long-term capital gain in excess of $50,000 cannot exceed 29½ percent for taxable years beginning in 1970 and 32½ percent for 1971. For taxable years beginning in 1972 and thereafter, the combined effect of the 50 percent capital gains deduction and the maximum 70 percent rate on ordinary income results in a maximum 35 percent rate with respect to the net long-term capital gain in excess of $50,000. A special proration to reflect the changes in rates must be made for fiscal year taxpayers.

Capital gains and losses are reported in separate Schedule D (Form 1040) reproduced on pages 8–9.

Example 2.—Mr. Brown sold 60,000 board feet of standing timber in a lump-sum sale on August 15, 1971, for $2,100. The timber was located on land acquired as part of his farm which he purchased on March 1, 1940. His cost or other basis of the timber sold was $355.80, computed as previously explained under "Determining Amount of Gain or Loss," and he paid $100 for a timber cruise in connection with the sale. He is engaged primarily in farming, and the timber is considered to be a capital asset in his hands. Mr. Brown has a long-term capital gain of $1,644.20 on the sale of the standing timber (sale proceeds of $2,100 less $455.80, which is the sum of his cost or other basis of the timber sold, $355.80, and the $100 expense of sale paid for the timber cruise). The transaction is entered in Part II of Schedule D, Form 1040, under "Long-term capital gains and losses—assets held more than 6 months," as follows:

Col. a.	Kind of property and description	Pine stumpage; 60,000 bd. ft. pine stumpage; lump-sum sale
Col. b.	How acquired	A
Col. c.	Date sold	8–15–71
	Date acq.	8–14–40
Col. d.	Gross sales price	$2,100
Col. e.	Cost or other basis and expense of sale.	$455.80 (Attach explanation).
Col. f.	Gain or loss (d. less e.)	$1,644.20.

The gain is carried forward as indicated on Schedule D, and the net taxable gain or loss is transferred to the tax return (Form 1040). In the absence of other capital assets transactions, only 50 percent of $1,644.20 or $822.10 is includable in taxable income.

If the timber had been held 6 months or less at date of sale, the transaction would have been entered in part I of Schedule D, under "Short-Term Capital Gains and Losses" and the full $1,644.20 (in the absence of offsetting long-term capital losses) would have been includable in taxable income.

Disposal of standing timber with an economic interest retained.—A disposal of timber with an economic interest retained occurs when a so-called "pay-as-cut" contract is executed and you are paid a stated amount per unit for the timber harvested. Since you retain ownership of the timber until the trees are cut by the purchaser, title does not pass when the sale is made. Proceeds of timber disposal with an economic interest retained are subject to special Internal Revenue Code provisions which offer two important advantages: your timber is included within a special tax category of "business property," and the question whether your timber is held for sale to customers does not arise. Only timber owned more than 6 months before disposal comes under the special provisions; if you owned the timber 6 months or less, the gain is treated as ordinary income.

The term "timber" for the purpose of the special provisions includes evergreen trees more than 6 years old when severed from the roots, which are sold for ornamental purposes such as Christmas trees.

There are three steps in reporting your gain or loss from disposal of timber under a pay-as-cut

contract. First, you determine the amount of gain or loss; second, you group the gain or loss with certain other gains and losses that you may have sustained during the taxable year; and third, you enter the transaction on Form 4797 reproduced on pages 10–11.

Determination of the gain or loss consists simply of subtracting from the gross sales price the sum of the cost or other basis and the expense of sale. The difference is your gain.

The taxable gains and losses that must be grouped are those from the following sales, exchanges, or other dispositions of property held more than 6 months:

1. The disposal with an economic interest retained of timber, iron, or coal held more than 6 months.
2. Timber held more than 6 months before the beginning of the taxable year, with respect to which you have elected to treat the cutting as a sale (explained under the heading "Cutting of Timber with Election to Treat as a Sale").
3. An unharvested crop sold with land, where the land has been held more than 6 months.
4. Livestock (not including poultry) acquired before 1970 for draft, breeding, or dairy purposes, and held 12 months or more.
5. Cattle and horses acquired after 1969 for draft, breeding, dairy or sporting purposes and held 24 months or more.
6. Sales or exchanges of real property, depreciable property, and leaseholds used in your trade or business, and held more than 6 months.
7. Business or nonbusiness property or property held for the production of rents or royalties which was subjected to a casualty or theft if held more than 6 months.
8. Notes, bonds, and other investment property subjected to a casualty or theft if held more than 6 months.
9. Property condemned for public use if held more than 6 months (this includes gains on business and investment property, and on property held for personal use, but only losses on business and investment property).

Example 3.—Mr. Black during 1971 disposed of timber under a pay-as-cut contract for $30 per thousand board feet. During September 60,000 board feet were cut as shown by scaling completed on September 23. Mr. Black received the amount due him, $1,800, on October 1. The timber was located on land purchased in 1940. His basis for the timber sold was $355.80 as in Example 1. He paid $200 in connection with the sale for a timber cruise, marking, and scaling, so that the gain was $1,244.20 ($1,800 less the sum of $355.80 and $200). Black also had certain other gains and losses during the year, all of which were of the type required to be grouped in the comparison of gains and losses discussed above.

Mr. Black's first step in determining how his gains and losses must be reported is to group and compare them, as follows:

(1) Deductible casualty loss from fire to personal residence (in excess of $100)	$(300.00)
(2) Total casualty and theft gains and losses (line 2, Form 4797)	$(300.00)
(3) Gain on sale of timber under cutting contract	$1,244.20
(4) Gain on sale of pastureland	500.00
(5) Loss on sale of livestock used for breeding purposes	(400.00)
(6) Total of items (line 4, Form 4797)	$1,344.20

Since total casualty and theft losses exceed total casualty and theft gains ((2) above), each casualty and theft item is treated as ordinary gain or loss. The personal casualty loss ((1) above) is only deductible on line 26, Schedule A (Form 1040). Since the total of all other items ((6) above) is a gain, these items ((3) through (5) above) are treated as capital gains and losses. The net amount ($1,344.20 gain) goes on line 8, Part II, Schedule D.

If gains had not exceeded losses when grouped as above, the net amount would be entered on line 6, Part II, Form 4797.

Cutting of timber with election to treat as a sale.—If you cut timber which you owned more than 6 months before the first day of the tax year in which it was cut and if such timber was cut for sale or for use in your business, you may elect to report your gain in two parts as follows:

1. The difference between the depletion basis of the standing timber cut and its fair market value as of the first day of the taxable year in which it was cut. This may usually be treated as a long-term capital gain.
2. The difference between the fair market value of such standing timber on the first day of the tax year and the proceeds from sales of resulting products (less processing costs). This must in all cases be treated as ordinary income.

Although the law does not require you to report the cutting of timber in this way, it is usually to your advantage to do so. Once this method has been elected, it must be continued until permission is obtained from the Internal Revenue Service to discontinue it.

In reporting your gain in two parts as just described, you first need to find the fair market value, as of the first day of the taxable year, of the standing timber that you cut. For this purpose you can usually use the local "going" price per thousand board feet, cord, or other unit for comparable stumpage in your area. Adjustments should be made if necessary to reflect the condition of your own timber. Your local Extension, farm, or service forester will probably be able to furnish a fair market value for stumpage in your area upon

request, or you may wish to consult a private practicing forester.

When you have determined the fair market value of the timber cut, the capital gain under numbered paragraph 1 is treated as in Example 3. The ordinary income under paragraph 2 is listed by farmers on Farm Schedule F as "other farm income" under "wood and lumber" or "other forest products." Other individuals would usually report such receipts on business Schedule C.

Example 4.—Mr. Jenkins, who files his tax return on a calendar year basis, cut 60,000 board feet of timber during 1971 from a tract which he had purchased in 1940. Also in 1971, he sold the resulting sawlogs at roadside for $3,300. The fair market value of the standing timber which he cut was determined to be $30 per thousand board feet, or $1,800, as of January 1, 1971. His basis of the timber cut (computed as explained under "The Amount of Gain or Loss," above) was $355.80. His logging and skidding costs amounted to $1,080. Mr. Jenkins had owned the timber for more than 6 months before the beginning of the year and he elected to treat the cutting as a sale. He also had other gains and losses during the year, all of which were of the type required to be grouped in the comparison of gains and losses discussed above.

Mr. Jenkins would determine the gain or loss on the cutting of the timber separately from the gain or loss from the sale of the sawlogs as follows:

Part I—Gain or loss on timber cutting treated as sale:

Fair market value, as of 1/1/71, of timber cut during year	$1,800.00
Less: Cost or other basis (depletion allowance)	355.80
Gain from cutting of timber	$1,444.20
Comparison of gains and losses required to be grouped:	
(1) Deductible casualty loss from fire to personal residence (in excess of $100)	($300.00)
(2) Total casualty and theft gains and losses (line 2, Form 4797)	($300.00)
(3) Gain on timber cutting treated as a sale	$1,444.20
(4) Gain on sale of pastureland	500.00
(5) Loss on sale of livestock used for breeding purposes	(400.00)
(6) Total of items (line 4, Form 4797)	$1,544.20

Combine all the gains and losses on line 3, Form 4797 and enter the net amount on line 6. Then combine all casualty and theft items listed on line 1, Form 4797.

Since total casualty and theft losses exceed total casualty and theft gains ((2) above), each casualty and theft item is treated as ordinary gain or loss. The personal casualty loss ((1) above), is only deductible on line 26, Schedule A (Form 1040).

Since the total of all items ((6) above) is a gain, these items ((3) through (5) above) are treated as capital gains and losses. The net amount ($1,544.20 gain) goes on line 8, Part II, Schedule D. A statement should be attached to Schedule D showing how the basis of the timber was computed plus any other necessary information.

If total gains had not exceeded total losses, none of the gains or losses would have been treated as capital gains and losses. The gain on the cutting of timber treated as a sale, the gain on the sale of pastureland, and the loss from sale of livestock, would all be reported in Part II, Form 4797 as ordinary gains and losses. The $300 deductible casualty loss from fire damages to his personal residence would be deductible by Mr. Jenkins only on Schedule A (Form 1040) and only if he itemizes his deductions.

Part II—Gain or loss from sale of sawlogs at roadside:

Proceeds from sale of sawlogs		$3,300
Less:		
Fair market value used as "sale price" in computing gain from cutting treated as sale	$1,800	
Logging and skidding costs	1,080	2,880
Gain on sale of sawlogs		$420

As explained above, this is treated as ordinary income. Mr. Jenkins would report this part of the transaction on business Schedule C (or, if he files a farm return, he could include it on Schedule F).

Sale of forest products other than standing timber.—Proceeds from sale of forest products other than standing timber are treated as ordinary income. This is true not only of products derived from harvested trees, such as logs, lumber, pulpwood, poles, mine timbers, crossties, fenceposts, fuelwood, or chips, but also of products derived from standing trees, such as gum naval stores, maple syrup, fruits, nuts, bark, and Christmas greens. Proceeds from sales of trees for landscaping purposes, such as balled nursery stock, are also treated as ordinary income.

Other receipts, such as agricultural program payments.—Government payments to cover the cost of conservation practices must be reported as ordinary income whether received in the form of cash, materials, or services. Such practices include forest tree planting, timber stand improvement such as thinning, cutting, girdling, or poisoning of cull trees and unwanted species, fencing as protection from cattle, and firebreak construction. Ordinary income treatment is applicable even though, as in tree planting, the related expenditures must themselves be capitalized for eventual recovery through the depletion allowance at such time as the planted trees become merchantable.

Casualties, Thefts, Condemnations

If your timber has been destroyed in whole or in part during the year, or if you have sustained loss by timber theft or condemnation of forest land for public use, you may be entitled to claim a deduction on your income tax return. In certain situations, because of insurance recovery or other compensation, the destruction, theft, or condemnation may result in a gain over the cost or other basis of the property. In such cases the gain must be included in your income unless you elect to postpone reporting such gain. For a more detailed explanation of how timber losses are reported see Agriculture Handbook No. 274, "The Timber Owner and His Federal Income Tax." Additional information may be found in IRS Publication 547, "Tax Information on Disasters, Casualty Losses, and Thefts," and IRS Publication 549, "Condemnations of Private Property for Public Use." The two latter pamphlets are available free from your local Internal Revenue Office.

Questions and Answers

1. *What is meant by "expensing" costs?*

Costs that are expensed are deducted from gross income for the year in which they are paid or incurred.

2. *What is meant by "capitalizing" costs?*

Costs that are capitalized are added to the basis or adjusted basis of the property and are recovered through depletion (in the case of timber), through depreciation (in the case of equipment and other depreciable assets), or upon sale (as in the case of land).

3. *Can a landowner obtain a tax deduction for reforesting idle land?*

Not at the time of planting. Costs of seeding and planting including labor must be capitalized and may be recovered through depletion when the timber becomes merchantable; such costs cannot be expensed.

4. *How do you determine the amount of gain or loss resulting from disposal of timber?*

The gain or loss, generally speaking, is the difference between what was received for the timber at time of disposal (less expense of sale) and its cost or other "basis" for depletion.

5. *How is depletion related to capital gains treatment?*

There is no direct relationship. Depletion affects the amount of gain or loss whereas capital gains treatment has to do with the type of gain or loss.

6. *What are the depletion unit and the depletion allowance?*

The depletion unit is found by dividing the basis or adjusted basis of the timber by the total number of units (board feet, cords, or other unit) in the timber account. The depletion allowance is found by multiplying the depletion unit by the number of units cut during the year.

7. *Does the income tax favor an owner who practices sustained-yield operation?*

Not in specific terms, but the capital gains provisions and those for expensing or capitalizing costs of forest ownership and operation do, in effect, encourage sustained-yield operation.

8. *Should a timber owner stagger his sales to avoid a higher income tax?*

This is not likely to be a serious problem when capital gains treatment applies. The tax applicable to net long-term capital gains cannot exceed 25 percent for gains not exceeding $50,000. Tax on portion of the gain in excess of $50,000 cannot exceed 29½ percent for 1970, 32½ percent for 1971, and 35 percent for 1972 and after. A special proration must be made for fiscal year taxpayers.

9. *Is timber growth taxable?*

Timber growth is not taxable as such.

10. *Are Christmas trees regarded as "timber" under the special capital gains provisions of the Internal Revenue Code?*

Yes, if such trees are more than 6 years old when severed from the roots and sold for ornamental purposes.

11. *Is the recognized loss of timber from fire or other casualty, theft, or condemnation based on its sound value before the loss?*

No. The loss recognized for tax purposes in the case of timber cannot be greater than the cost or other basis of the timber destroyed, less any insurance or other recoveries.

12. *How do you determine the amount of loss to your timber from fire or other cause?*

Get an accurate estimate of the quantity destroyed and multiply it by the depletion unit; see answer to preceding question. A local public or private consulting forester can be asked to estimate the volume of the timber before and after the loss.

A reproduction of Schedule D (Form 1040), Capital Gains and Losses and Form 4797, 1971 follows.

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SCHEDULE D (Form 1040)
Department of the Treasury
Internal Revenue Service

Capital Gains and Losses

▶ Attach to Form 1040. ▶ Examples of property to be reported on this Schedule are gains and losses on stocks, bonds, and similar investments, and gains (but not losses) on personal assets such as a home or jewelry.

1971

Name(s) as shown on Form 1040 | Social security number

Part I Short-term Capital Gains and Losses—Assets Held Not More Than 6 Months

D

	a. Kind of property and description (Example, 100 shares of "Z" Co.)	b. How acquired. Enter letter symbol (see instructions)	c. Mo., day, yr. (Put date sold above dotted line and date acquired below dotted line)	d. Gross sales price	e. Cost or other basis, as adjusted, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	f. Gain or (loss) (d less e)
1						

2	Enter your share of net short-term gain or (loss) from partnerships and fiduciaries	2		
3	Enter net gain or (loss), combine lines 1 and 2	3		
4(a)	Short-term capital loss component carryover from years beginning before 1970 (see Instruction H)	4(a)		
4(b)	Short-term capital loss carryover attributable to years beginning after 1969 (see Instruction H)	4(b)		
5	Net short-term gain or (loss), combine lines 3, 4(a) and 4(b)	5		

Part II Long-term Capital Gains and Losses—Assets Held More Than 6 Months

6						

7	Capital gain distributions	7		
8	Enter gain if applicable from line 4(a)(1), Form 4797 (see Instruction A)	8		
9	Enter your share of net long-term gain or (loss) from partnerships and fiduciaries	9		
10	Enter your share of net long-term gain from small business corporations (Subchapter S)	10		
11	Net gain or (loss), combine lines 6 through 10	11		
12(a)	Long-term capital loss component carryover from years beginning before 1970 (see Instruction H)	12(a)		
12(b)	Long-term capital loss carryover attributable to years beginning after 1969 (see Instruction H)	12(b)		
13	Net long term gain or (loss), combine lines 11, 12(a) and 12(b)	13		

Part III Summary of Parts I and II

14	Combine the amounts shown on lines 5 and 13, and enter the net gain (loss) here	14		
15	**If line 14 shows a gain**—			
	(a) Enter 50% of line 13 or 50% of line 14, whichever is smaller (see Part VI for computation of alternative tax). Enter zero if there is a loss or no entry on line 13	15(a)		
	(b) Subtract line 15(a) from line 14. Enter here and on line 35, Form 1040	15(b)		
16	**If line 14 shows a loss**—See Instruction I.			
	▶ Omit lines 16(a) and 16(b) and go to Part IV if losses are shown on lines 12(a) and 13.			
	▶ Otherwise,			
	(a) Enter **one** of the following amounts:			
	(i) If amount on line 5 is zero or a net gain, enter 50% of amount on line 14;			
	(ii) If amount on line 13 is zero or a net gain, enter amount on line 14; or,			
	(iii) If amounts on line 5 and line 13 are net losses, enter amount on line 5 added to 50% of amount on line 13	16(a)		
	(b) Enter here and on line 35, Form 1040, the smaller of:			
	(i) The amount on line 16(a);			
	(ii) $1,000 ($500 if married and filing a separate return—if losses are shown on lines 4(a) and 5, see Instruction K for a higher limit not to exceed $1,000); or,			
	(iii) Taxable income, as adjusted (see instruction J)	16(b)		

Part IV Capital Loss Limitation—Where Losses are Shown on Lines 12(a) AND 13

17	Enter loss from line 5; if line 5 is zero or a gain, enter a zero		17	
18	Enter loss from line 13		18	
19	Enter gain, if any, from line 5; if line 5 is zero or a loss, enter a zero		19	
20	Reduce loss on line 18 to the extent of the gain, if any, on line 19		20	
21	Combine lines 3 and 11 and if gain, enter gain; if zero or a loss, enter a zero **NOTE:** If the entry on line 21 is zero, OMIT lines 22 through 28, and enter on line 29 the loss shown on line 12(a).	21		
22	Enter gain, if any, from line 11	22		
23	Enter smaller of amount on line 21 or line 22	23		
24	Enter excess of gain on line 21 over amount on line 23	24		
25	Enter loss from line 4(a); if line 4(a) is blank, enter a zero	25		
26	Reduce gain, if any, on line 24 to the extent of loss, if any, on line 25	26		
27	Enter loss from line 12(a)	27		
28	Add the gain(s) on line(s) 23 and 26	28		
29	Reduce the loss on line 27 to the extent of the gain, if any, on line 28		29	
30	Subtract amount on line 29 from the loss on line 20		30	
31	Enter 50% of the amount on line 30		31	
32	Add lines 17, 29, and 31		32	
33	Enter here and on line 35, Form 1040, the smaller of: (a) Amount on line 32; (b) Taxable Income, as adjusted (see Instruction J); or, (c) $1,000 ($500 if married and filing a separate return—see Instruction K for a higher limit not to exceed $1,000)		33	

Part V Complete Part V if Losses are Shown on Lines 4(a), 5, AND 14 (See Instruction L)

34	Combine lines 3 and 11 and if gain, enter gain; if zero or a loss, enter a zero	34	
	NOTE: If the entry on line 34 is zero, OMIT lines 35 through 41, and enter on line 42 the loss shown on line 4(a).		
35	Enter gain, if any, from line 3	35	
36	Enter smaller of amount on line 34 or line 35	36	
37	Enter excess of gain on line 34 over amount on line 36	37	
38	Enter loss from line 12(a); if line 12(a) is blank, enter a zero	38	
39	Reduce the gain, if any, on line 37 to the extent of the loss, if any, on line 38	39	
40	Enter loss from line 4(a)	40	
41	Add the gain(s) on line(s) 36 and 39	41	
42	Reduce the loss on line 40 to the extent of the gain, if any, on line 41	42	

Part VI Computation of Alternative Tax (See Instruction T to See if the Alternative Tax Will Benefit You)

43	Enter amount from line 50, Form 1040	43	
44	Enter amount from line 15(a)	44	
45	Subtract amount on line 44 from amount on line 43	45	
46	Enter smaller of amount on line 13 or line 14	46	
	If line 46 does not exceed $50,000 ($25,000 if married filing separately), check this block ☐ and omit lines 47 through 56.		
47	Enter long-term gains from certain binding contracts, distributions, and installment sales (referred to as "certain subsection d gains"—see Instruction T)	47	
48	Enter amount from line 47 or $50,000 ($25,000 if married filing separately), whichever is larger	48	
	If line 48 is equal to or greater than line 46, check this block ☐ and omit lines 49 through 56.		
49	Multiply amount on line 48 by 50%	49	
50	Add amounts on lines 45 and 49	50	
51	Subtract amount on line 48 from amount on line 46	51	
52	Tax on line 43 or 44, whichever is greater (use Tax Rate Schedule in instructions)	52	
53	Tax on the amount on line 50 (use Tax Rate Schedule in instructions)	53	
54	Subtract amount on line 53 from amount on line 52	54	
55	Multiply amount on line 51 by 32½%	55	
56	Enter smaller of amount on line 54 or 55	56	
57	Tax on the amount on line 45 (use Tax Rate Schedule in instructions)	57	
58	If the block on line 46 or 48 is checked, enter 50% of line 44; otherwise enter 25% of line 48	58	
59	Alternative Tax—add amounts on lines 56 (if applicable), 57, and 58. If smaller than the tax figured on the amount on line 50, Form 1040, enter this alternative tax on line 19, Form 1040	59	

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Form **4797**
Department of the Treasury
Internal Revenue Service

Supplemental Schedule of Gains and Losses

Sales, Exchanges and Involuntary Conversions under Sections 1231, 1245, 1250, etc.

To be filed with Form 1040, 1041, 1065, 1120, etc.—See Instruction A

1971

Name

Identifying number as shown on page 1 of your return

Part I Sales or Exchanges of Property Used in Trade or Business and/or Involuntary Conversions (Section 1231)

SECTION A.—Involuntary Conversions Due to Casualty and Theft (See Instruction D)

a. Kind of property (if necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements (if not purchased, attach explanation) and expense of sale	g. Gain or (loss) (d plus e less f)
1						

2 Combine the amounts on line 1, enter here and also on the appropriate line as follows . . . . . .

(a) For all returns, except partnership returns:
(1) If line 2 is zero or a gain, enter such amount in column g, line 3.
(2) If line 2 is a loss, enter the loss on line 5.
(b) For partnership returns: Enter the amount shown on line 2, on line 10, Schedule K (Form 1065).

SECTION B.—Sales or Exchanges of Property Used in Trade or Business and Certain Involuntary Conversions (Not Reportable in Section A) (See Instruction D)

3						

4 Combine the amounts on line 3, enter here and also on the appropriate line as follows . . . . . .

(a) For all returns, except partnership returns:
(1) If line 4 is a gain, enter such gain as a long-term capital gain on the Schedule D (Form 1040, 1120, etc.) that is being filed—see instruction D.
(2) If line 4 is zero or a loss, enter such amount on line 6.
(b) For partnership returns: Enter the amount shown on line 4, on line 9, Schedule K (Form 1065).

Part II Ordinary Gains and Losses

a. Kind of property and how acquired (If necessary, attach statement of descriptive details not shown below)	b. Date acquired (mo., day, yr.)	c. Date sold (mo., day, yr.)	d. Gross sales price	e. Depreciation allowed (or allowable) since acquisition	f. Cost or other basis, cost of subsequent improvements and expense of sale	g. Gain or (loss) (d plus e less f)
5 Amount, if any, from line 2(a)(2)						
6 Amount, if any, from line 4(a)(2)						
7 Gain, if any, from line 21						
8						

9 Combine lines 5 through 8, enter here and also on the appropriate line as follows . . . . . .

(a) For all returns, except individual returns: Enter the gain or (loss) shown on line 9, on the line provided for on the return (Form 1120, etc.) being filed—see instruction E, for specific line reference.

(b) For individual returns:

(1) If the gain or (loss) on line 9, includes losses which are to be treated as an itemized deduction on Schedule A (Form 1040) (see instruction E), enter the total of such loss(es) here and on line 26, Schedule A (Form 1040)—identify as loss from line 9(b)(1), Form 4797 . . . . . .

(2) Redetermine the gain or (loss) on line 9, excluding the loss (if any) entered on line 9(b)(1). Enter here and on line 36, Form 1040 . . . . . .

Part III **Gain From Disposition of Property Under Sections 1245, 1250, 1251, 1252—Assets Held More Than Six Months (See Instruction F)**

Lines 18 and 19 should be omitted if there are no dispositions of farm property or farm land; or, if this form is filed by a partnership.

10 Description of sections 1245, 1250, 1251, and 1252 property:	Date acquired (mo., day, yr.)	Date sold (mo., day, yr.)
(A)		
(B)		
(C)		
(D)		
(E)		

Correlate lines 10(A) through 10(E) with these columns ▶ ▶ ▶ ▶	Property (A)	Property (B)	Property (C)	Property (D)	Property (E)
11 Gross sales price					
12 Cost or other basis and expense of sale					
13 Depreciation allowed (or allowable)					
14 Adjusted basis, line 12 less line 13					
15 Total gain, subtract line 14 from line 11					
16 If section 1245 property:					
(a) Depreciation allowed (or allowable) after applicable date (see instructions)					
(b) Line 15 or line 16(a), whichever is smaller					
17 If section 1250 property:					
(a) Enter additional depreciation after 12/31/63 and before 1/1/70					
(b) Enter additional depreciation after 12/31/69					
(c) Enter line 15 or line 17(b), whichever is smaller					
(d) Line 17(c) times applicable percentage (see instruction F.4)					
(e) Enter excess, if any, of line 15 over line 17(b)					
(f) Enter line 17(a) or line 17(e), whichever is smaller					
(g) Line 17(f) times applicable percentage (see instruction F.4)					
(h) Add line 17(d) and line 17(g)					
18 If section 1251 property:					
(a) If farm land, enter soil, water, and land clearing expenses for current year and the four preceding years					
(b) If farm property, other than land, subtract line 16(b) from line 15; OR, if farm land, enter line 15 or line 18(a), whichever is smaller (see instruction F.5)					
(c) Excess deductions account (see instruction F.5)					
(d) Enter line 18(b) or line 18(c), whichever is smaller					
19 If section 1252 property:					
(a) Soil, water, and land clearing expenses made after 12/31/69					
(b) Enter amount from line 18(d), if any; otherwise, enter a zero					
(c) Enter excess, if any, of line 19(a) over line 19(b)					
(d) Line 19(c) times applicable percentage (see instruction F.5)					
(e) Line 15 less line 19(b)					
(f) Enter smaller of line 19(d) or line 19(e)					

Summary of Part III Gains (Complete Property columns (A) through (E) up to line 19(f), before going to line 20)

20 Total of Property columns (A) through (E), line 15	
21 Total of Property columns (A) through (E), lines 16(b), 17(h), 18(d), and 19(f). Enter here and on line 7	
22 Subtract line 21 from line 20. Enter here and in appropriate Section in Part I (see instructions D and F.2)	

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